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Effects of Eliminating the Distinction between Full Cash and Net Limited Property Value on Property Tax

Prepared for the Citizens Finance Review Commission

by

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The specific proposals the CFRC received was to eliminate the distinction between net full cash value and net limited property value and require tax rates, levy limits and voter approved spending to apply to a property's net full cash value.

1. <u>Description</u>

Property taxes are currently applied to two sets of values: net full cash values and net limited property values. In general, the net full cash value is the base for bonds, overrides and special districts and the net limited property value is the base for maintenance and operations budgets of schools and municipalities. The limited value cannot exceed the full cash value and normally is lower as statutory limits on valuation increases are applied to the limited value. For tax years 2002 and 2003, net limited values represented 94.7% and 93.8% of net full cash values respectively.

The values reviewed in this topic are considered "net" assessed values, which is after the application of assessment ratios. Utilizing only a property's full cash value would not take into account the impact of assessment ratios. The consideration is that the elimination of the distinction between full cash values and limited property values applies to the net amount and does not eliminate assessment ratios. As a reference, net full cash values are used for "secondary" taxes and net limited values are used for "primary" taxes.

2. <u>Administration</u>

The administration of this change will actually be a simplification of taxable values, as only one value will be utilized instead of two. Programming changes will be required on Department of Revenue, Assessor and Treasurer systems, although these changes most likely will not be extensive. The distinction of primary and secondary taxes would probably have to be kept intact as the impact of the homeowner's rebate on primary school taxes and the 1% residential cap would still need to be monitored. Statutory and Constitutional changes would be needed to cleanup references to "primary" or "limited" values if the rebate and cap were eliminated.

From a valuation standpoint, only statute ARS 42-13301 would need to be changed. This statute creates the calculation of primary values. If this statute were changed to state that limited property values would equal full cash values, the differences in values would be eliminated. Statutes ARS 42-13302 thru 13304 would also need to be revised or eliminated as they relate to ARS 42-13301. As an example, ARS 42-13304 states that certain classes, personal property for one, already have their limited values equal to their full cash values.

In general, the administration of property taxes would continue as it exists today with the minor change of having one "full cash value" instead of the current system of two taxable values.

3. <u>Impact on Existing Revenue Systems</u>

The elimination of the limited property value should not impact other existing revenue systems.

4. Cost

The initial administrative costs of the implementation of one value should be fairly minimal with some minor programming changes being required of the Department of Revenue, Assessors and Treasurers. The long run costs should actually produce some savings as the maintenance and review of two values would be eliminated.

This change would not require any additional administrative costs for businesses or individual taxpayers.

5. Policy Considerations

Equity

The elimination of limited property values would actually produce equity among taxpayers as everyone would be paying based on their full cash value. The protection against sharp valuation increases would not be phased in over a number of years, which currently insulates some taxpayers.

Economic Vitality

The simplification of Arizona's complicated property tax structure will allow businesses to more easily compare our tax burden with other states.

Volatility

Eliminating the limited property value will allow the property tax base to follow with current market values. Large valuation increases are not fully realized until the limited property value has been allowed to reach the full cash value. As an example, a 40% valuation increase will currently take four years to be fully realized within the limited property valuation. However, from the taxpayer standpoint, the limited value does allow a more gradual increase of the tax burden when faced with a large valuation increase.

Simplicity

One property taxation value will definitely simplify the property taxation process. This holds for both the administrators of the tax and the public.

6. Economic Impact

The elimination of the limited property value will have some potential economic impacts. If the limited values were equal to or replaced with the full cash values, the primary tax base would have increased 5.6% in 2002 and 6.7% in 2003. Using 2002 statewide, net assessed values, the primary tax base would go from $34.87 billion to $36.83 billion. This is an increase of $1.96 billion in net assessed value which would produce $167 million in tax revenue based on the 2002 average primary tax rate of $8.56 per $100 of net assessed value.

This $167 million may not be fully realized as school rates may be adjusted down with the increase in the tax base. The 1% cap may limit the amount of increase. Municipalities may also have to reduce rates if they are capped by their levy limits, which should not be impacted by this change in limited property value because new limited values would be treated as appreciation using current calculations. However, many municipalities are not at their levy limit and would be able to reap the benefit of the additional tax base if they did not lower their tax rate.

The impact will also vary by county as each county experiences different ratios between limited values and full cash values. The table below shows the 2002 net full cash values and net limited values as well as the 2002 and 2003 ratios of limited value to full cash value for all of the counties in Arizona. As shown in the table, Maricopa and Pinal are on the low end around 93% to 94%, while Greenlee is on the high end approaching 100%. The makeup of property within a county will impact their ratio. Greenlee, for example, has a high ratio because so much of their value is personal property, which has limited value equal to full cash value (a ratio of 100%). The ratios also vary from year to year based on valuation increases within each county.

In regards to property tax liability for 2002, the limited value constituted 68.5% of the tax bill (an $8.56 tax rate of the total 2002 tax rate of $12.49).

County	2002 Net Full Cash Value	2002 Net Limited Value	2002 Limited Ratio	2003 Limited Ratio
Apache	$289,174,959	$281,639,817	**97.4%**	**98.1%**
Cochise	$554,220,855	$537,740,609	**97.0%**	**97.2%**
Coconino	$1,084,878,819	$1,048,503,739	**96.6%**	**97.0%**
Gila	$357,161,346	$331,626,188	**92.9%**	**95.5%**
Graham	$99,614,664	$96,954,674	**97.3%**	**98.8%**
Greenlee	$180,770,442	$180,356,400	**99.8%**	**99.9%**
La Paz	$122,304,607	$120,512,244	**98.5%**	**95.8%**
Maricopa	$24,457,047,282	$22,955,864,882	**93.9%**	**92.6%**
Mohave	$1,074,965,098	$1,047,527,651	**97.4%**	**97.4%**
Navajo	$601,395,341	$569,467,908	**94.7%**	**96.1%**
Pima	$4,837,084,048	$4,667,364,797	**96.5%**	**96.1%**
Pinal	$863,865,161	$816,902,130	**94.6%**	**93.2%**
Santa Cruz	$235,055,570	$228,063,060	**97.0%**	**97.5%**
Yavapai	$1,452,202,552	$1,389,566,793	**95.7%**	**94.7%**
Yuma	$615,920,229	$596,505,334	**96.8%**	**97.2%**
Totals	**$36,825,660,973**	**$34,868,596,226**	**94.7%**	**93.8%**
Source: 2002 and 2003 Department of Revenue Abstracts.				